Hong Kong Society of Accountants

Submission on the Companies (Amendment) Bill 2002

Introduction

1. The Hong Kong Society of Accountants ("the Society") has reviewed the provisions of the Companies (Amendment) Bill ("the Bill") and welcomes the initiative to implement some of the recommendations made in the "The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance" dated February 2000.

2. While we support most of the proposals contained in this Bill, we put forward below certain suggestions for further changes to certain of the provisions.

A. Companies (Amendment) Bill 2002

Clause 54 – Directors vicariously liable for acts of alternates

3. Clause 54 proposes to add a new section 153B into the Companies Ordinance ("the Ordinance") to the effect that, unless the articles of association contain any provision to the contrary, an alternate is the agent of the director who appoints him and the director shall be vicariously liable for torts committed by his alternate.

4. The Society queries the all-embracing nature of this proposed provision. There may be situations in which a company director in practice has no control over the appointment and actions of the person who is his alternate. Under such circumstances, it would seem to be inequitable to make the director vicariously liable for torts committed by his alternate.

5. In addition, as the term "alternate director" is not defined under the Ordinance, the Society proposes that its meaning should be statutorily defined to clarify the scope of the proposed provision.

Clause 57 – Removal of directors

6. Clause 57 proposes to amend section 157B such that a director may be removed by an ordinary resolution instead of a special resolution. Nevertheless, under the proposed section 157(B)(1A) special notice is required of a resolution to remove a director or to appoint somebody in place of a director so removed at the meeting at which he is removed, i.e. the company must give notice to its members at the same time and in the same manner as it gives notice of the meeting or, if that is not practicable, it must nevertheless give notice via a newspaper advertisement or other means allowed by the articles, at least 21 days before the meeting. The Society believes that, to enhance the effectiveness and flexibility of the proposed provision, in the case of a private company, consideration should be given to allowing the requirement regarding special notice to be waived with the unanimous consent of the members of the company.

Clause 58 – Prohibition of loans, etc. to directors and other persons

7. Clause 58 proposes to replace section 157H with new provisions to extend the prohibition against a company making a loan to a director or other relevant persons, or providing a guarantee or security for such a loan, to cover more modern forms of credit, i.e. quasi-loans and credit transactions. Section 157HA stipulates that certain types of transactions are exceptions to this prohibition. Section 157HA(6) clarifies that the prohibition does not apply to a company "if the ordinary business of that company includes the entering into of transactions of that description". However, subsection (8) makes it clear that this does not authorise a company to enter into a credit transaction as creditor for any director of the company, or other relevant persons, even where such transactions are within the ordinary business of the company, if at the time of the transaction, the aggregate of the amounts specified in section 157HA(8) exceeds HK$500,000.

8. The Society is of the view that this could be unduly restrictive. We would firstly like to seek clarification as to whether there is any empirical evidence as to what, under the circumstances, would constitute a reasonable threshold. If there is a need to specify a ceiling, and we are not clear that there is, given the parameters stated in section 157HA(6) that the ordinary course of business of the company must include entering into transactions of that type, then we would suggest that perhaps a formula could be devised that would have regard to size of transactions that are usual for a particular company. Otherwise, the proposed provisions would appear to have the effect of preventing companies from entering into a normal arm's length transaction with its directors, etc., in cases where the business of the company is, for example, the sale of luxury cars, which could easily exceed $500,000 in value in an ordinary transaction.

Clause 63 – Particulars in accounts of loans to officers

9. Clause 63 proposes to replace section 161B with a new provision to provide that the accounts to be laid before a company in general meeting shall contain the particulars of every relevant transaction (as defined), e.g. the name of the borrower, the terms, the outstanding amount, any overdue amount, and the amount of any provision made in respect of failure or anticipated failure to repay.

10. The Society is of the view that the proposed disclosure requirements could be unduly onerous and in practice overload financial statements with details that would not be useful to most users. Instead, it is suggested that disclosure requirements similar to those in the Hong Kong Statement of Standard Accounting Practice on Related Party Disclosures (SSAP 2.120) be adopted, such that items of a similar nature may be disclosed in aggregate. The aim of disclosing similar items in aggregate is to avoid voluminous disclosures. For the purposes of the new section 161B, for example, the company should be required only to disclose the total amount involved, the total opening balance and closing balance, and the total provision made in respect of failure or anticipated failure to repay, if any, in respect of all the relevant transactions, rather than the details of each transaction that took place during the company's financial year, as proposed in Clause 63.

Clause 65 – Contracts with sole member who is also a director

11. Clause 65 proposes to insert a new section 162B into the Ordinance to provide that, where a company having only one member enters into a verbal contract with that member (other than those entered into in the ordinary course of the company's business) and that member is also a director of the company, the company shall ensure that the terms of the contract are set out in a written memorandum within 7 days after the contract is made.

12. We would suggest that some further clarification should be given as to the purpose of introducing this requirement for companies with one member.

Clause 66 – Provisions as to liability of officers and auditors

13. Generally we support the proposal to clarify the position under section 165 of the Ordinance regarding the purchase by a company of insurance on behalf of its directors and officers, as this has been a matter of some doubt for a long period of time.

14. This proposed provision appears to be based on similar legislation in the UK Companies Act 1985 (as amended by the Companies Act 1989), which, like the Companies Ordinance, also contains a general prohibition on a company granting exemptions or indemnities to its officers and auditors against any liabilities in respect of their negligence, breach of duty, etc. towards the company. However, there are some apparent differences between the Bill and the UK legislation.

15. The proposed new section 165(3)(a), which permits insurance to be purchased for officers or auditors against liabilities arising from negligence, breach of trust etc. (not involving fraud) towards the company, may help to ensure that, in the event of justifiable claims, monies will be available to claimants, who are likely to be the company and/or third parties.

16. However, the proposed new section 165(3)(b) of the Ordinance provides for insurance to be purchased by the company for its officers or auditors, to cover any liability incurred in defending proceedings for negligence, breach of duty, etc. towards the company, even where fraud is ultimately proved to have been involved. The UK Companies Act does not contain any explicit provision similar to this, although it may be argued that the general nature of section 310(3)(a) in the Companies Act would not rule out such a possibility. Nevertheless, the purpose of this part of the clause is not entirely clear and we would suggest that some further clarification on this point may be called for.

Clause 108 – Meeting by electronic means

17. Clause 108 proposes to amend regulation 1 in Part I, Table A of the First Schedule to the Ordinance to provide, inter alia, that wherever any provision of the regulations requires that a meeting of the company, its directors or members, be held, the requirement may be satisfied by the meeting being held by electronic means.

18. The Society is of the view that the meaning of "electronic means" should be more clearly defined, perhaps by reference to examples of the more common modes of communication.

B. Other proposed amendments to the Companies Ordinance

Re: Clause 7 (section 22 of the Companies Ordinance) – Change of name

19. Under section 22(2) of the Ordinance, where a company has been registered by a name which is (a) the same as, or, in the opinion of the Registrar of Companies (the "Registrar"), too like a name appearing at the time of the registration in the Registrar's index of company names; (b) the same as, or, in the opinion of the Registrar, too like a name which should have appeared in that index at that time; or (c) the same as or, in the opinion of the Registrar, too like the name of a body corporate incorporated or established under any Ordinance at the time of the registration, the Registrar may within 12 months of that time direct the company to change its name.

20. The Society is of the view that the time limit of one year is not sufficiently long to prevent abuses by way of, e.g. registering dormant companies by names which are the same as or very similar to those of other companies. As the former companies are not active, it would be less likely that anyone would identify the similarity in names during the relevant period. In such cases, if the Registrar has not exercised his power under section 22(2) to order a change of name during the one-year period, the existing owners of the names in question may have to resort to a passing-off action for remedy.

21. We would suggest therefore that the opportunity be taken in Clause 7 of this Bill to further amend section 22 by extending the time limit within which the Registrar may direct a company to change its name under section 22(2) to, say, five years from the date of its registration.

10 October 2002